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## 2011 Year End Commentary and 2012 Outlook

*Welcome to my year end commentary and a look at the road ahead. For newcomers, this time of year presents me with an opportunity to reflect on the past year and on expectations for the coming one without the annoying effects of rational debate from other people. So, here are my thoughts about what we've seen, and what we might see this year. Enjoy.*

### **The Year in Review**

The year 2011 started out on a high note and ended on one too. What happened in the middle was at times noisy, frantic, and bothersome. So, like a Kardashian wedding, we are happy it's over with.

The clear winner for global headline news was the Euro Zone crisis. (Running a close second – Osama Bin Laden and Moammar Ghaddafi, with assists from Navy SEALs' and freedom fighters, both succeeded in their pursuit of martyrdom.) The ongoing drama in Europe can best be summed up in the following recipe:

“First, start with a heaping helping of massive debt. Add some more debt for good measure. Then, sprinkle in some cultural denial. Stir in some ineffective leadership. Throw in a dash of finger pointing and refusal to accept the truth. Mix in lots of lack of accountability. Add some more debt. Bake at 350° until it looks like it's going to explode. Repeat.” There you have it.

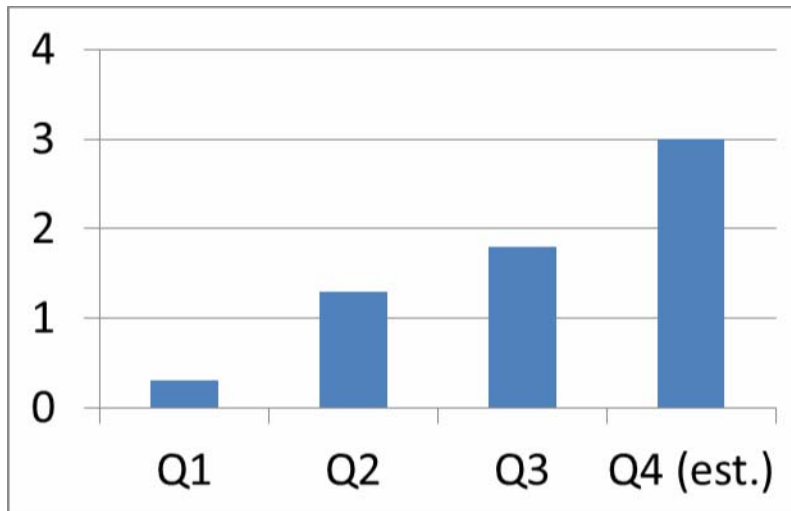
On the domestic front, 2010 ended with the Dow Jones at 11,576. In April of 2011, it reached 12,800. Then, the wheels sort of fell off or at least looked like they had. Real Gross Domestic Product (GDP) slowed sharply, the unemployment rate ticked higher and the stock market had a meaningful (16%) correction. By August, both retail sales and non-farm payrolls were reported as big fat zeros. Markets continued to seesaw.

Tornados tore up Tuscaloosa, AL and Joplin, MO. A tsunami hit Japan and a major nuclear drama unfolded. Then, Washington went to war over the debt ceiling. Standard & Poor's downgraded the US Treasury debt. A rare earthquake struck Washington DC, but failed to destroy a single government agency. The SuperCommittee, in true bipartisan Washington spirit, announced it was giving up after accomplishing exactly nothing. MF Global declared bankruptcy. Finally, large groups of people got fed up with lots of stuff and gathered together to protest, well, something. I'm still not quite sure what.

During this entire melee, the doomsayers woke up, turned the amplifier up to 11, and started screaming about imminent recession. In August, Nouriel Roubini (aka Doctor Doom, who accurately called the 2008 crisis) said, “The macro data...will come out worse and worse. We're going into a recession, we are at stall speed, and we are running out of policy bullets.” He had lots of company screaming double dip recession throughout the year.

Instead of a 2011 recession, the economy slowed, but then picked up speed as the year progressed. Real GDP for 2011 looks like this:

#### 2011 US Gross Domestic Production (GDP)



Source: First Trust Advisors, Monday Morning Outlook, 12/27/11

Anybody notice a trend here?

So what does all this suggest? Two choices for you to select from:

1. 2011 was an economic miracle. Somebody call the Pope.
2. Nobody knows anything about the future, and economic forecasting exists to make astrology look respectable.\*

At the risk of repeating myself, one of the primary points I've driven home time and again on this subject is:

**Nobody "fixes" the economy. The economy fixes itself. Sometimes, it just takes longer because politicians are "helping" it.**

In terms of unemployment, it's been a continuing problem as we predicted. But, it's fallen from 9.4% in late 2010 to 8.6% currently. Before you get too excited, this is largely due to fewer people losing their jobs, and not to greatly increased hiring. (Some people have given up even trying to work – take Congress, for example.) Still, 42 states last month reported a drop in their unemployment rates. The month before, 36 states reported the same. So, it's getting better, but slowly.

So, how did all this upheaval translate into client portfolios? In the face of all this economic uncertainty, we saw both domestic and global markets turn south. While US market results ended the year mixed, most global indices ended down, resulting in slightly negative returns for those clients with broadly diversified portfolios. Here's a picture of the performance of the major stock & bond indices for the past year:

## GLOBAL INDICES

Dow Jones Global Index	-9.9%
MSCI EAFE (Intl Stocks)	-11.7%
MSCI Emerging Markets	-16.2%

## DOMESTIC INDICES

Dow Jones Industrial Ave.	5.5%
S&P 500 (Large Stocks)	0.0%
NASDAQ Composite	-1.8%
Russell 2000 (Small Stocks)	-5.5%

## BONDS/COMMODITIES

Barclays 1-3 yr credit bond	2.1%
Barclays Aggregate Bond	7.5%
DJ-UBS Commodity Index	-13.4%

*Source: Wall Street Journal, 1/3/2012. An index is an unmanaged group of securities considered to be representative of stock markets in general. Investors cannot invest directly in an index*

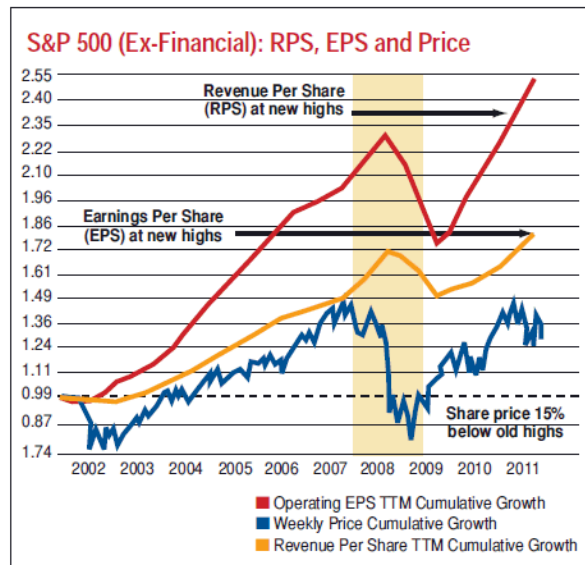
(Perhaps the best indicator of global market performance is the first one - the Dow Jones Global Index, which tracks equity results across 42 countries.)

So, that about sums up the look behind. Now, let's turn our attention to what's ahead.

In terms of the global economic outlook, the picture is mixed. All eyes today are on Europe, which shows every sign of retreating into recession as the New Year starts. It's beginning to look like the Euro Zone debt crisis will not (one way or the other) resolve itself quickly. As such, some of the uncertainty and the potential for an "event shock" - i.e., you wake up one morning, and the name "Greece" has been replaced by "New Germany" - is declining somewhat, at least for now. We would expect that 2012 will hold plenty of ups and downs across the pond, much like 2011. The global stock and bond markets appear to have priced in these expectations.

But on a domestic basis, we are beginning to see signs that 2012 could turn out to be a much better year economically than many expect. With unemployment steady to slightly waning, an expansion in manufacturing, new housing starts improving, and consumer debt on the decline, the forecasts for economic growth of between 3% and 4% for 2012 seem plausible. (Anything over 3% GDP growth, the unemployment numbers start getting better faster.) Of course, this momentum could be derailed by an event shock in Europe (such as Greece or Portugal pulling a "dine-and-dash" and leaving the Euro Zone) or perhaps by political events in November, but with each passing quarter the domestic economy shows tremendous resilience. So we're hoping for a more robust 2012. Time will tell.

In terms of investment market expectations, we're optimistic - particularly absent any event shocks as mentioned earlier. I have continued to talk about the widening gap between the actual fortunes of corporate America and the world versus their stock prices. There are a lot of ways to look at this, but here's a chart which shows the gap between earnings and stock prices pretty plainly.



Source: Intrinsic Research

What the chart says is this: Corporate revenues and earnings have never in history been higher, which means stock prices should be higher too. But they're not. At least not yet. (What the chart doesn't show is that profit margins are at 20 year highs, and corporate debt levels are a multi-decade lows as well. More good news.) This pattern cannot continue indefinitely. Either all these signs of corporate health and wealth have to deteriorate, or stock prices have to go back up. The general consensus is that all the political and economic uncertainty, coupled with the debt crisis, has suppressed stock prices while corporate earnings have continued to rise. In other words, the markets are very efficient at pricing in the potential for trouble. So, from a market perspective, we're starting out 2012 about where we were in early 2011. But, the corporate picture – which drives stock market returns – is much healthier than it was a year ago. **So what you're left with is the question of whether the global economic worries will continue to dominate stock market returns, or whether the value and economic health of all these great companies will finally be reflected in their prices.** Put another way, the question isn't what else can go wrong in 2012 so much as it is what can go wrong at these market prices that isn't built in already? Absent any big shocks, we are siding with a more optimistic view.

### And Finally...Occupy Wall Street Gets an "F" on Their Homework

A wise man once said, "You're entitled to your own opinions, but you aren't entitled to your own facts." If you require any more evidence that the folks at these Occupy protests do not have a clue as to what they are protesting, here's an atom bomb of a rejoinder you can share at your next cocktail party or sit-in.

If there is a primary platform on which these protests are based, it's the notion that all these greedy corporations screwed up, forced Congress and the taxpayer to bail them out, got rich, and now are sticking it to the little guy again, who is still holding the tab from all the bailouts. Sound about right? Well, ProPublica, the nonpartisan research organization, tracks the bailout results. Here's where we stand: The Fed, through the TARP program, loaned a total of \$412 billion out. It's collected \$279 billion of it back. Further, it's received in the form of dividends and interest, another \$72 billion back. It's estimated it will collect the remaining balances over the course of the next two years while it continues to collect interest payments, resulting in a healthy net profit to taxpayers. Bloomberg reports that, of the \$309 billion it loaned to banks and insurance companies, the government earned \$25.2 billion (an 8.2% return) in interest, dividends, and repayments between October 2008 and October 2010. And Treasury Secretary Geithner testified before Congress that he expects a nice profit for the American people from the AIG loan payback, which was largely cast by pundits as

throwing money down a rat hole. To date, the Federal government and the US taxpayers *have not lost a single dime* from the TARP bailouts, and stand to make a nice profit when it's all said and done. So stick that in your protest pipe and smoke it. Please note that I do not condone or condemn bailouts per se – I'm simply citing the facts as reported. If you are one of the 99%, I respect your right to protest. I also respect your right to free speech. But get your facts straight. It looks silly to protest something that just ain't so.

In closing, we look forward to serving you through 2012. I hope you'll be able to attend our quarterly **"The Road Ahead"** webinars, so stay tuned for dates and times. And as always, please don't hesitate to call.

Regards,

Jeff Helms, CFA

*\*With apologies to John Kenneth Galbraith.*

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